20020/42
IGSL

REPORT ON A

SEPARATE AUDITOR DEPARTMENT

April, 1975

Report by the Task Force on the Auditor-Controller

Catherine Graeffe Burke, Chairperson
Muriel Pfaelzer Bodek
John D. Byork
Anne S. Collins
Earl J. Sachs
Larkin Teasley
Bryan Walker

INSTITUTE OF GOVERNMENTAL STUDIES LIBRARY

APR 3 0 1992

UNIVERSITY OF CALIFORNIA

Other Commission Members

Maurice Rene Chez, Chairman
Rudolph A. Cervantes
Dr. Robert J. Downey
Jerry Epstein
Theodore S. Flier
Milton G. Gordon
Mrs. Ray Kidd
Joseph A. Lederman
Leo A. Majich
Robert Ruchti, II
Dr. Warren H. Schmidt
George Shellenberger

Commission Staff

Burke Roche, Executive Secretary
John J. Campbell, Staff Specialist
Maxlynn Larsen, Secretary to Commission

Digitized by the Internet Archive
in 2026 with funding from
State of California and California State Library

https://archive.org/details/C101695577

PREFACE

In a Board Order dated November 19, 1974, the Board of Supervisors requested the Economy and Efficiency Commission to report on the 1973 Grand Jury's recommendation that the Audit Division of the Auditor-Controller's office be made a separate department. The recommendation was:

> It is recommended that necessary legal action be taken to transfer the internal audit function from the Auditor-Controller Department and give it full departmental status, reporting directly to the entire Board of Supervisors.

In accordance with our usual practice, the commission chairman appointed a task force to study the issue. On December 17, 1974, we provided the Board with a progress report which identified some of the legal implications of the Grand Jury's proposal and some of the central questions related to it.

This report presents the final conclusions and recommendations of the task force. It is based on over 30 interviews with concerned County officials, the Chairman of the Audit committee of the 1973 Grand Jury, former Grand Jury contract auditors, and other authorities in the field. The task force also conducted an investigation of the operation of the Audit Division, reviewed published auditing standards, and analyzed the costs and benefits that would result from the Grand Jury's recommendations.

TABLE OF CONTENTS

SECTION		PAGE
	Preface	i
I.	Summary of Recommendations	1
II.	Organization and Cost	2
III.	Legal Changes	4
IV.	Duties and Responsibilities	5
V.	Recommendations	7
	Recommendation 1	7
	Recommendation 2	14
	APPENDICES	
	A. Office of County Auditor-Controller - Current Organization Chart	16
	B. Auditor Department - Proposed Organization Chart	24
	C. Controller Department - Proposed Organization Chart	26
	D. Auditor Department - Schedule of Proposed Additional Administrative Staff Costs	28
	E. County Counsel Opinion	29

I. SUMMARY OF RECOMMENDATIONS

The task force makes the following recommendations. They are discussed in full in the body of the report.

1. *The Audit Division should remain within the organization of the Auditor-Controller.*

2. *The Board of Supervisors should request the Grand Jury to conduct full scale audits of the Board offices, the Chief Administrative Office, and the Auditor-Controller at least once every three years. The Board should furnish the Grand Jury with the necessary budget to conduct these audits.*

II. ORGANIZATION AND COST

Reorganizing the Audit Division as a separate department would require a net budgetary increase of eight positions over the current staffing of the division.

Currently, as shown in Appendix A, the Audit Division has 120 positions of the 602 in the department. These include the division chief, his secretary, five professional auditing sections with 101 positions, a section for claims and collections with 13 positions, and a records section with four positions. In the current organization, the Administrative and Personnel Section of the Executive Office furnishes administrative services to the division.

In Appendices B and C, we illustrate the organization that would be required to make the Audit Division a separate department. Two new departments would result - the Auditor Department (Appendix B) and the Controller Department (Appendix C). We have assumed for purposes of comparison that each of the new departments would parallel corresponding units of the current organization, except for positions required to maintain the Audit Division as an independent department.

As shown in Appendix B, making the Audit Division a department would require a director, a chief deputy, and two secretaries to replace the division chief and one secretary. In addition, an administrative services division with 10 positions would be required to replace the current one with four. The section for claims and collections would be deleted from the new department, but would reamin with the Controller in the reorganization (as indicted in Appendix C). Thus the new organization would require a net increase of eight positions

- two in the executive office and six in administrative services. There would be no corresponding decrease in the Controller's department.

The requirement for an increase of eight budgeted positions would result in an estimated annual expense of $142,236 for personnel. The computation is delineated in Appendix D. It is based on 1974 salary levels, as well as on the assumption that there would be parity between corresponding positions in the two new departments. Although some of the details might differ in a full scale classification and budget analysis, we are convinced that the estimated figure of approximately $142,000 is accurate for purposes of analyzing the Grand Jury's proposal.

III. LEGAL CHANGES

If the Grand Jury's proposal is approved, some specific duties will be assigned to the Auditor and some to the Controller. The County Counsel advises us that the resulting changes to the State law as well as the County Ordinance and the County Charter will be substantial.

The duties of the Auditor-Controller are outlined in many sections of State law. There is also a great deal of crossover between the duties of the Auditor and the Controller, with little distinction drawn in many cases between the two functions. In addition, State law prescribes that the County Auditor shall also hold ex officio the position of County Controller. Consequently, the two positions are combined in all counties in the State.

The County Ordinance (Ordinance 4099, Article IV B) and the County Charter (Sections 14, 20, 38, and 53) do not mention the position of County Controller. They refer only to the position of County Auditor. Some of the duties prescribed therein appear to be more closely related to the functions of a controller than to those of an auditor. Therefore, it appears that changes in both these documents will also be required. While it would not be difficult to change the County Ordinance, the changes required in the County Charter would have to be submitted to the voters at the next general election in 1976.

Appendix E contains County Counsel's opinion on this subject.

IV. DUTIES AND RESPONSIBILITIES

In our progress report of December 17, we said that we would analyze the specific duties to be assigned to the proposed new Auditor Department. Essentially, these would be the same as the current duties of the Audit Division of the Auditor-Controller's Department.

The Audit Division performs the internal post-auditing function for County management. A post-audit is an examination of financial transactions that have been completed or are in process at the end of a standard accounting period or at the time the audit is conducted. In contrast, many pre-auditing functions are performed by other divisions in the department of the Auditor-Controller. They are examinations of financial transactions before their completion - for example, to guarantee accurate computation of amounts owed the County.

Internal audits are performed for management by employees in the organization. They differ in many respects from independent audits of corporations performed for third parties, such as stockholders and the public, by public accounting firms. For example, internal audits need not be limited to financial matters - they may be concerned with informing management of operational improvements. Ordinarily, independent external audits are not directly concerned with fraud unless it materially affects the published financial statements. Internal audits are directly concerned with fraud detection and prevention, as well as with the systems of controls established to prevent it.

Within the framework of internal post-audits, the Audit Division conducts various continuing assignments. There are statutory requirements for post-audits of several County departments and agencies, in particular,

treasury funds, the tax collection system, the retirement system, the Municipal Court Districts, the special districts, and the cash accounts of the Probation Department. The division also conducts post-audits of County contracts as provided by statute, by order of the Board of Supervisors, or by the contracts themselves. Finally, the division conducts continuing and repeated audits of all County operating departments, as a matter of Board policy.

V. RECOMMENDATIONS

The task force has concluded that creating a separate auditor department as the 1973 Grand Jury recommended would not result in sufficient benefit to the County to justify the additional cost.

Recommendation 1.

> *Therefore, we recommend that the Audit Division remain within the organization of the Auditor-Controller.*

Analysis

The potential benefits of a separate department can be identified by determining whether and to what extent a separate department would improve the effectiveness, the independence, the enforcement of audit findings, the objectivity, and the efficiency of the audit function.

Effectiveness - An internal audit function is effective if it succeeds in identifying and correcting problem situations before they become crises and if it furnishes sufficient information to provide accountability for financial management.

According to these criteria, the current audit functions are seriously deficient in their effectiveness. Clearly the crises and problems which have erupted in the County in recent years demonstrate a lack of effectiveness in correcting problems before they erupt into crises. There is no reason to expect, however, that a separate auditor department would be more successful in correcting problems than the current audit division. In the County the Board of Supervisors acts as both the legislative and executive head of the government. Thus, ultimately the Board is responsible for enforcing audit findings.

There is evidence that the effectiveness of the audit function has suffered from a lack of Board attention, at least up until the Board order of March 17, 1974, requiring that all audit reports be filed directly with the chairman of the subject department. Our staff's analysis of audits of the Public Administrator-Public Guardian and several hospitals, which were filed with the Board, demonstrates that the Board had sufficient information to avert recent scandals, but lacked formal enforcement mechanisms until March, 1974.

This situation appears now to be substantially improved. A Board order, dated March 26, 1974, requires audit reports to be delivered to the Board member acting as chairman of the audited department. The Auditor-Controller, Mr. Bloodgood, assures us that this mechanism has been useful in facilitating action on recent audit recommendations.

Independence - Proponents of a separate auditor say that a separate auditor's department would increase the level of independence of the audits. This would strengthen their credibility. Moreover, the Board of Supervisors would have assurance that no one, except the Board, could affect the annual audit program, the subjects of planned audits, or the content of audit reports. Thus, according to this argument, the Board would be kept informed and would focus more attention on requiring department heads to implement the auditor's recommendations.

However, the Audit Division now meets most reasonable practical tests of independence within the framework of its current organization. To test independence our staff searched for instances in which Audit Division work had been compromised by departmental management. In conducting this search, they interviewed eight current and former employees of the division, several public

accountants, and three former contract auditors of the Grand Jury. Although a number of those interviewed expressed some concern about the possibility of abuse of auditors' independence, none offered any concrete evidence of instances in which independence had been compromised by the suppression of information, revision of reports, or other means.

To provide an independent check on the same question, our staff reviewed in detail the results of six audits conducted by the Audit Division since June, 1972, and interviewed the personnel responsible for them. They found no evidence that departmental management had deleted or otherwise distorted auditors' findings and recommendations. In one case, management had proposed editorial changes which the staff opposed; the changes were not made and the staff version remained in the report.

In a number of cases the staff pointed out that editorial changes and changes in the tone of reports are necessary to meet the objective of internal auditing - that is, to convince management to make the necessary changes.

Regardless of their independent attitudes and professional objectivity, internal auditors in Los Angeles County government will always lack credibility in any attempt to audit the operating offices of the Board, the Chief Administrative Office, and their own department. Strict independence is impossible. The Board of Supervisors is the chief executive of the County. The Chief Administrative Officer has the power of budget preparation. In both cases, an auditor would have to consider potentially severe consequences of reporting adverse information. That is true within the current County structure, whether the audit function is placed in a department or a division.

No one is able to conduct an objective and credible audit of his own operations or those of his superiors. In this theoretical sense, the audit division does not meet certain standard tests of independence.

According to generally accepted public and governmental accounting standards, as published by the General Accounting Office of the U.S. Congress and by the American Institute of Certified Public Accountants, both the placement of an auditing function in an organization and its level within the organization can impair its independence. In Los Angeles County the Audit Division is placed in the department of the chief accounting officer, a department which is also responsible for disbursing funds and for establishing accounting systems. In addition, the division is placed at the third echelon within the department and four levels below the County's chief executive, the Board of Supervisors.

A separate department would meet these additional theoretical tests of independence, with respect to auditing the Auditor-Controller. It would not with respect to auditing the Board offices or the Chief Administrative Office.

We should note, also, that placement of audit functions in a separate, top level department is not common practice in the private sector, although it is more common in banking and insurance than in other companies. In a Conference Board survey in 1963, 70% of the firms surveyed had their internal auditor placed in the finance department, usually reporting to the chief financial officer. In the private sector, firms usually contract with public accountants for independent audits.

To determine the practice in government, our staff interviewed the internal auditors of eight local governments in the United States. In five cases, the internal auditor is a separate and independent department. However, in each such case the government is structured into legislative and executive branches. In the other cases, independent audits were furnished by state

governments or by contractors - in California by Grand Jury contractors. The internal audit responsibility was placed either in the office of finance or in a chief administrative office. In several cases, the independence of the contractor was enhanced by providing for long term contracts of up to five years and for mandatory rotation of contractors.

Thus, on the question of independence we conclude: Creating a separate auditor department would not materially enhance the independence of the audit function.

Enforcement - In several cases, some members of the audit staff pointed out that the department has no means to enforce its recommendations. Auditor-Controller management prefers to convince the managers of departments subject to an audit that the recommendations should be implemented to improve their operations. But there is no systematic follow-up. Implementation is up to the department audited and to the Board member in charge of that department. Some members of the audit staff believe that this situation would improve if their division were raised to the status of a department. However, a separate audit department - like the present Audit Division - would also have no authority to enforce its recommendations. No internal auditor does. In Los Angeles County the authority and responsibility for enforcement lie with the Board of Supervisors.

Objectivity - Our staff interviewed the directors of six departments that have been audited since 1972 to identify any serious criticism of auditors' objectivity or independence. Again, we found no evidence of any serious suppression or modification of information by the Auditor-Controller.

We did find in a few instances that the division's credibility was impaired because of flaws in the County's overall accounting system, which is the responsibility of the department of the Auditor-Controller. For example,

entry of financial data into the Controller's central control accounts may be behind schedule and thus out of phase with the operating financial data of the department audited. In such cases, it is difficult for the Audit Division to convince the audited department's management to use the central control records as mandated by County policy.

Some of the auditors believe that they would be better able to review the central accounting system and identify its weaknesses if they were in a separate department. However, this would not correct the situation. The same flaws in the system would provide excuses for management not to implement audit recommendations. Since the Grand Jury can and does conduct audits of the Auditor-Controller, there is no advantage in furnishing additional internal capability for such audits.

Thus, it is clear that there is no substantive evidence of any lack of objectivity or independence of attitude and operation in the Audit Division. To the contrary, we have seen positive evidence in several reports that the auditors do criticize systems, policies and controls installed or operated by the Auditor-Controller.

Efficiency - Proponents of a separate department say that it would benefit the County because the department head would be able to focus his full attention on the audit function. This would result, they say, in more attention by the Board to executive action on audit reports. In addition, they believe that efforts to upgrade the level and quality of the staff would be more successful than they have been in the past, since the department director would no longer be concerned with allocating resources among competing functions as the current department director is.

There is validity to this logic. Surely, the full attention of a department head would be theoretically more prestigious and might carry more

weight with the Board and other department heads than that of a division chief. It is countered, though, by the equally valid point that a division chief's job is to focus full attention on the needs of his organization. The presence of a department head between the division and the Board provides some insulation from Board and interdepartmental politics - a benefit of the current organization.

Our principal concern, however, is that a separate auditor department would add still another department to compete for the Board's attention. It would increase the Board's administrative burden, which already requires the supervision of 54 departments and over 100 commissions and committees reporting directly to the Board. It would further fragment an already highly fragmented organization.

Summary - A separate auditor department, it is estimated, would cost an additional $142,000 a year. Establishing such a department might result in improvements in the effectiveness, objectivity, and efficiency of the County's internal audit function. But as the above analysis indicates, measuring the extent of these improvements tends to become highly conjectural and theoretical. Moreover, we have not been able to find evidence that the current organizational placement of the Audit Division either impairs or compromises the independence and objectivity of the audits. Nor, as we have discussed, would raising the internal audit function to departmental status have any effect on deficiencies in the County's enforcement mechanisms.

On the other hand, it is clearly demonstrable that a separate auditor department reporting to the Board of Supervisors as chief executive and subject to budgetary control by the Chief Administrative Officer would continue to lack true independence. We conclude, therefore, that a separate auditor department would not justify the additional annual expense of $142,000.

Recommendation 2.

> *We recommend that the Board of Supervisors ask the Grand Jury to conduct full scale audits of the Board offices, the Chief Administrative Office, and the Auditor-Controller at least once every three years. The Board should furnish the Grand Jury with sufficient budget to conduct such audits.*

Analysis

In the California county structure, the contract auditor of the Grand Jury enjoys an independent status. Thus, one of the chief responsibilities of the contract auditor should be to conduct a periodic audit of those functions that the internal auditor cannot credibly audit. Establishing these specific audits as the primary responsibility of the contract auditor would ensure a much greater guarantee of maintaining an efficient and effective internal audit function than the establishment of a separate audit department.

Some of the authorities we consulted suggested that it might be preferable for the Board of Supervisors to contract directly for such audits, as corporations do for auditors' opinions on their financial statements. We think, however, that the Grand Jury is in a better position to insure strict independence, and that their audits would have high credibility with the public and County employees.

As several contract auditors have pointed out, a standard auditors' opinion on the County's financial statements is not possible at present. The County does not have the financial records necessary to support such an opinion. We should note also that a number of authorities in governmental auditing and accounting question the utility of such opinions.

What Grand Jury audits of the Board offices, the Chief Administrative Office, and the Auditor-Controller would accomplish is an independent assessment of their financial controls and accountability, as well as the efficiency

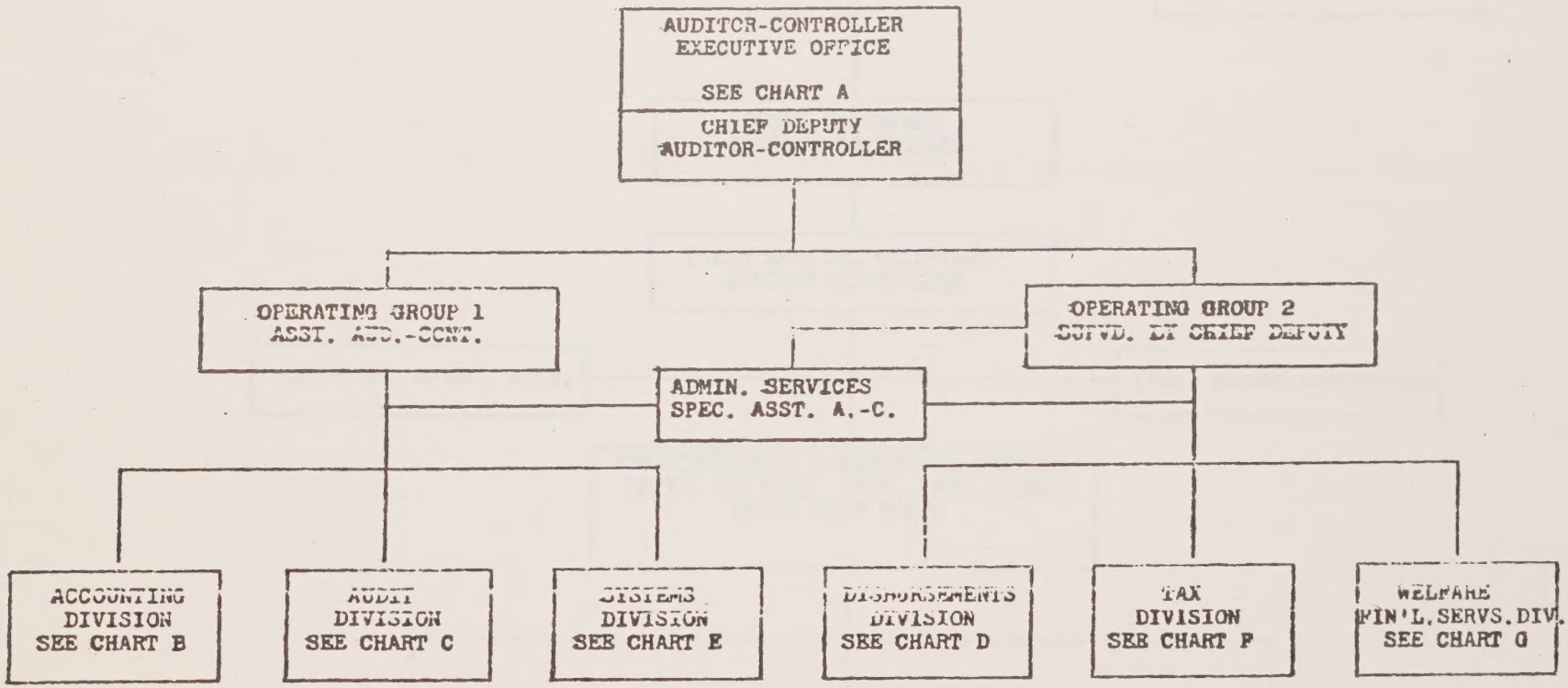
and integrity of their financial operations. In the case of the Auditor-Controller, in particular, such audits would address the weaknesses of central accounting and financial information systems that presently hamper the Audit Division's effectiveness.

It is important to note that we are suggesting that the Board request the Grand Jury to audit the operations of the entire department in each of these three cases. In the past the usual practice has been to conduct audits of separate divisions. This request will add to the auditing responsibilities that the Grand Jury now has. Consequently, it may require an increase in its auditing budget. This increase would be unlikely to exceed an average of $50,000 a year - one-third of the annual increased cost of a separate auditor department. These outside audits ought to be much more productive than those of a new department, whose independence is limited. Consequently, we conclude that the additional cost is justified.

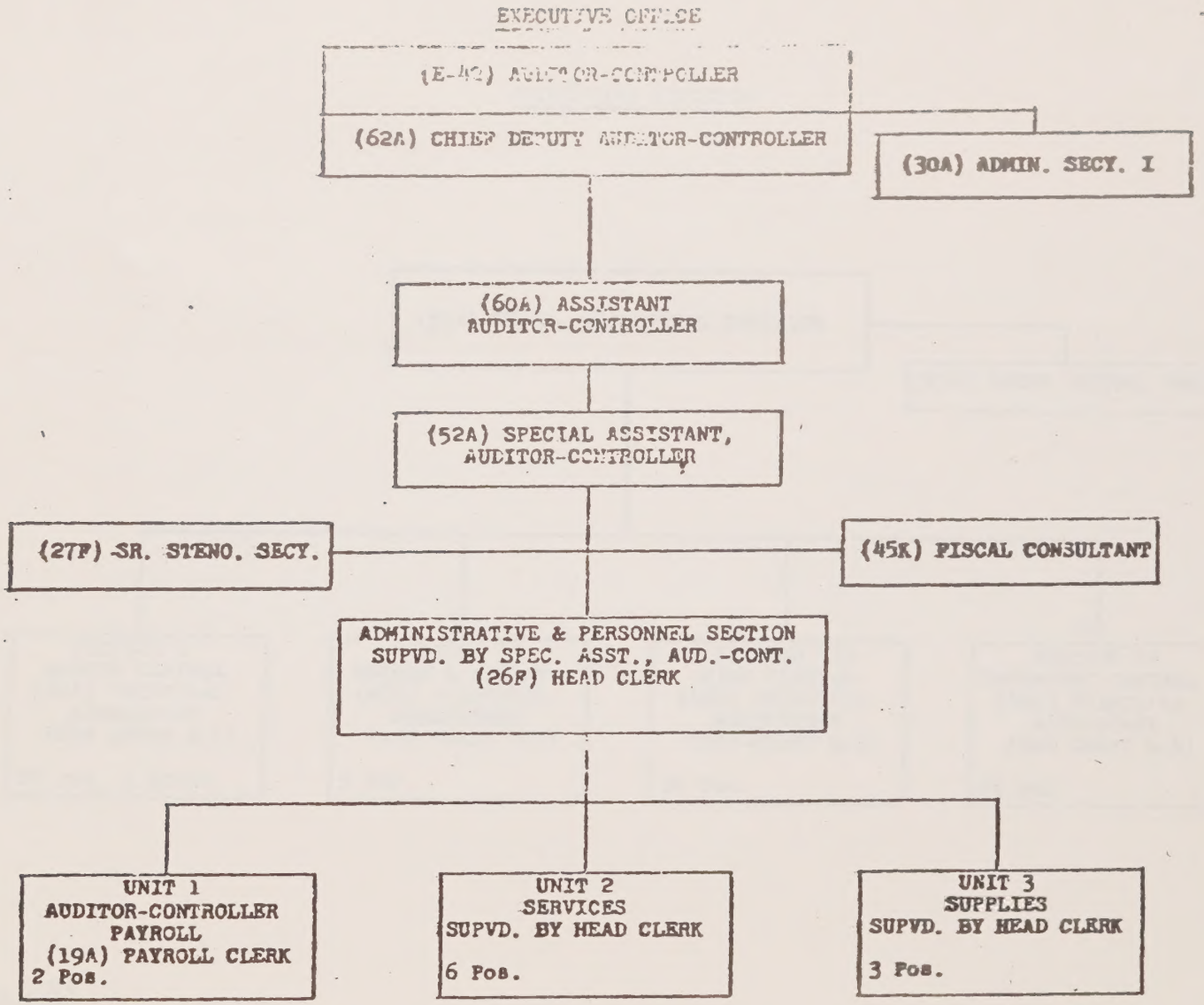
OFFICE OF COUNTY AUDITOR-CONTROLLER

CURRENT ORGANIZATION CHART

Total Positions - 602

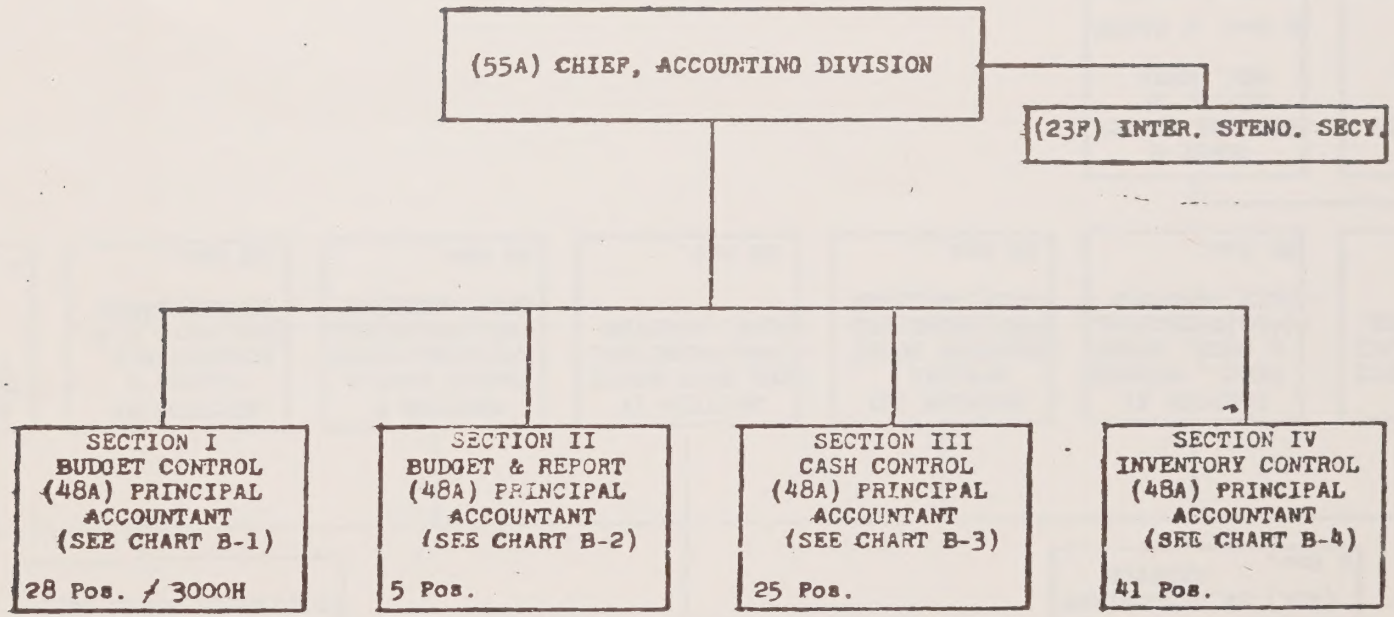


July 1, 1974


EXECUTIVE OFFICE
(E-42) AUDITOR-CONTROLLER
(62A) CHIEF DEPUTY AUDITOR-CONTROLLER
(30A) ADMIN. SECY. I
(60A) ASSISTANT AUDITOR-CONTROLLER
(52A) SPECIAL ASSISTANT, AUDITOR-CONTROLLER
(27F) SR. STENO. SECY.
(45K) FISCAL CONSULTANT
ADMINISTRATIVE & PERSONNEL SECTION
SUPVD. BY SPEC. ASST., AUD.-CONT.
(26F) HEAD CLERK
UNIT 1
AUDITOR-CONTROLLER
PAYROLL
(19A) PAYROLL CLERK
2 Pos.
UNIT 2
SERVICES
SUPVD. BY HEAD CLERK
6 Pos.
UNIT 3
SUPPLIES
SUPVD. BY HEAD CLERK
3 Pos.

July 1, 1974

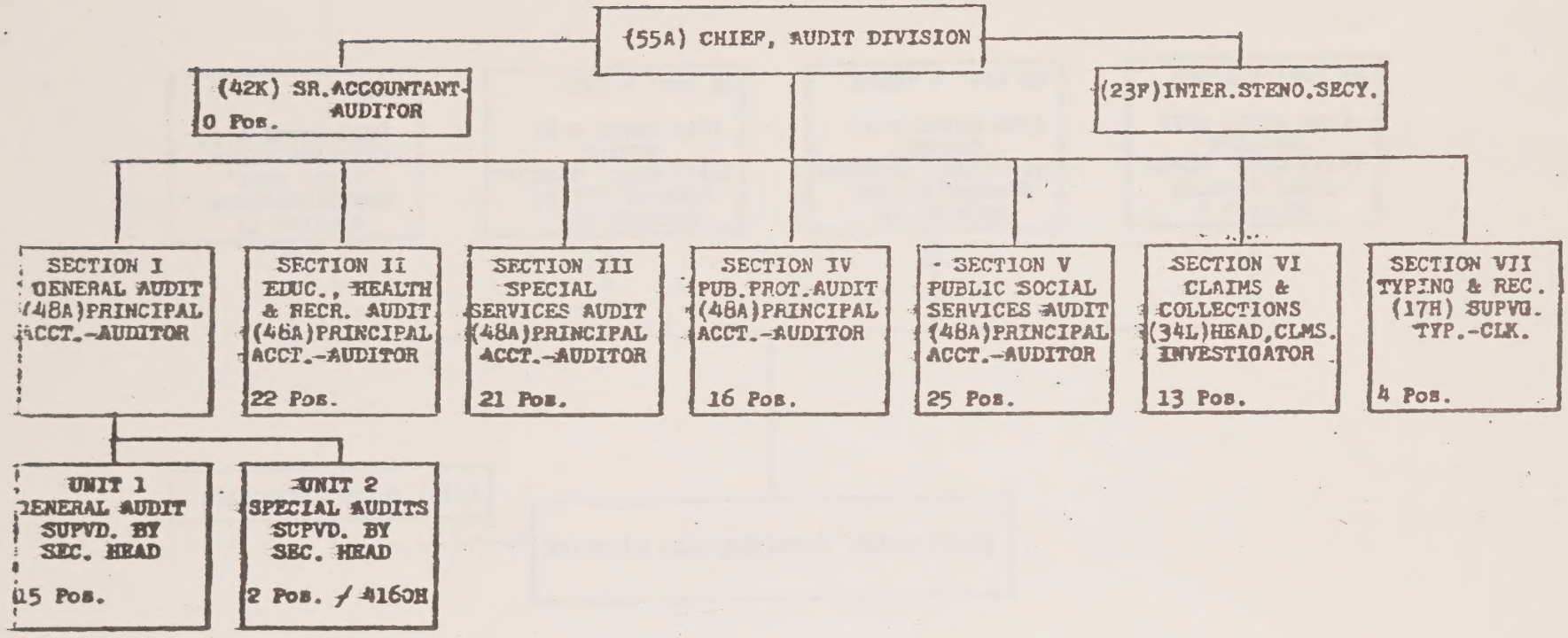
ACCOUNTING DIVISION



July 1, 1974

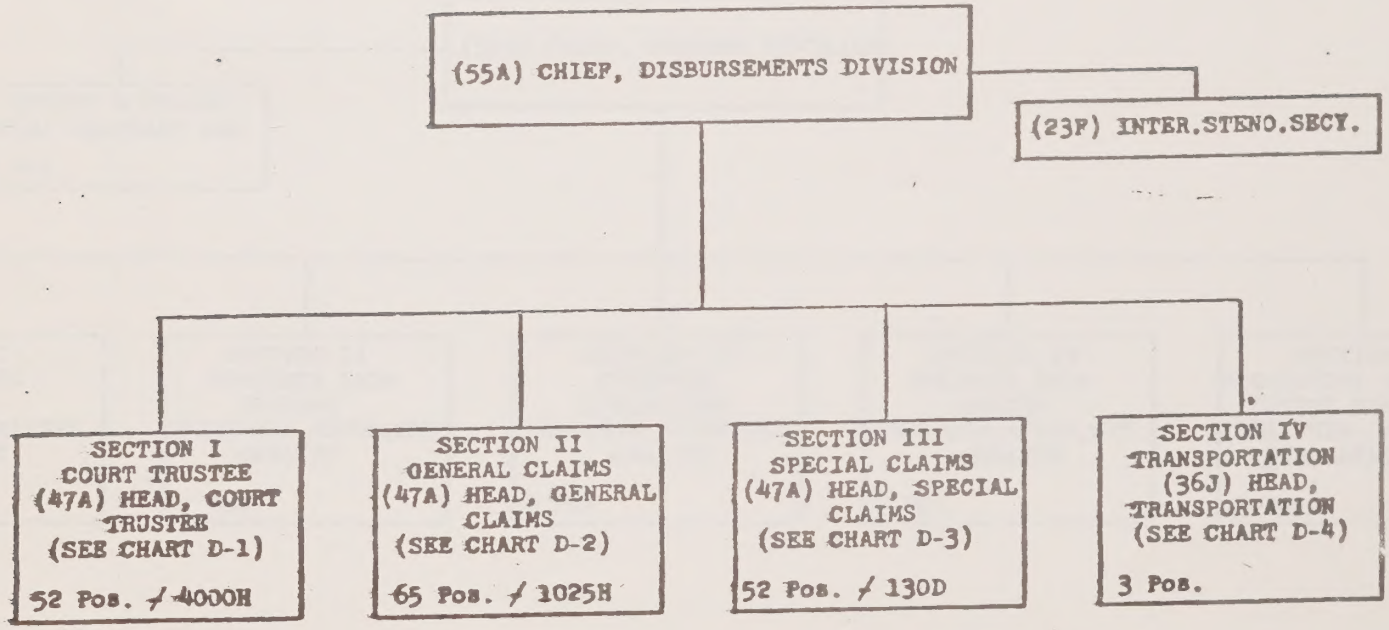
AUDIT DIVISION

CHART C



July 1, 1974

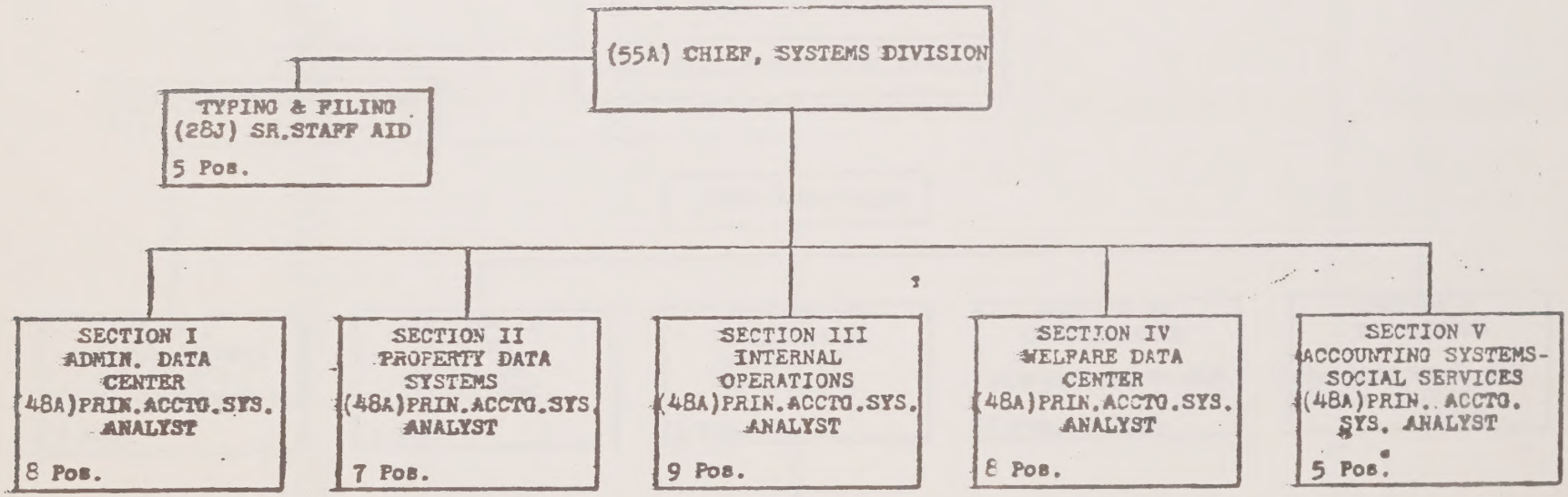
DISBURSEMENTS DIVISION



July 1, 1974

CHART E

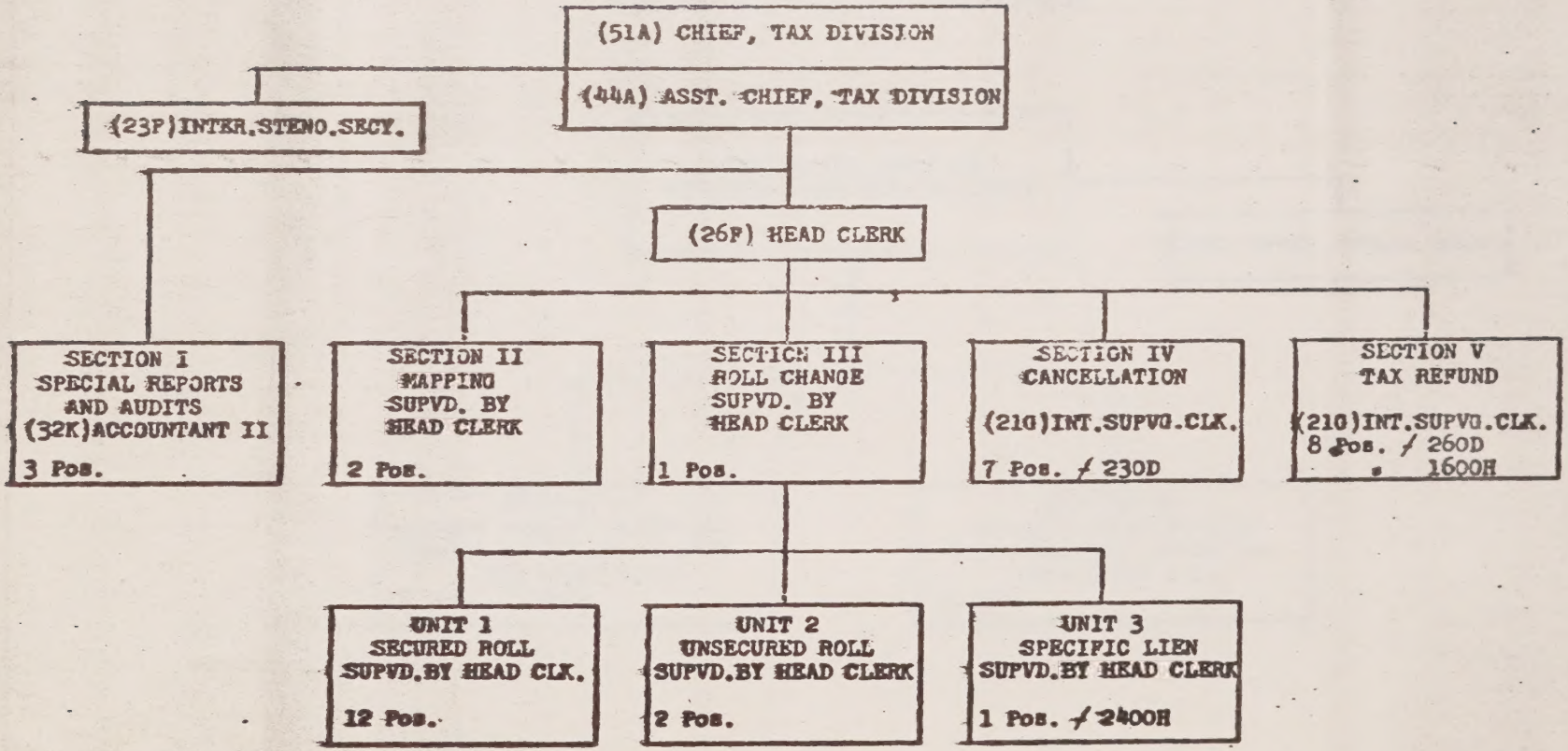
SYSTEMS DIVISION



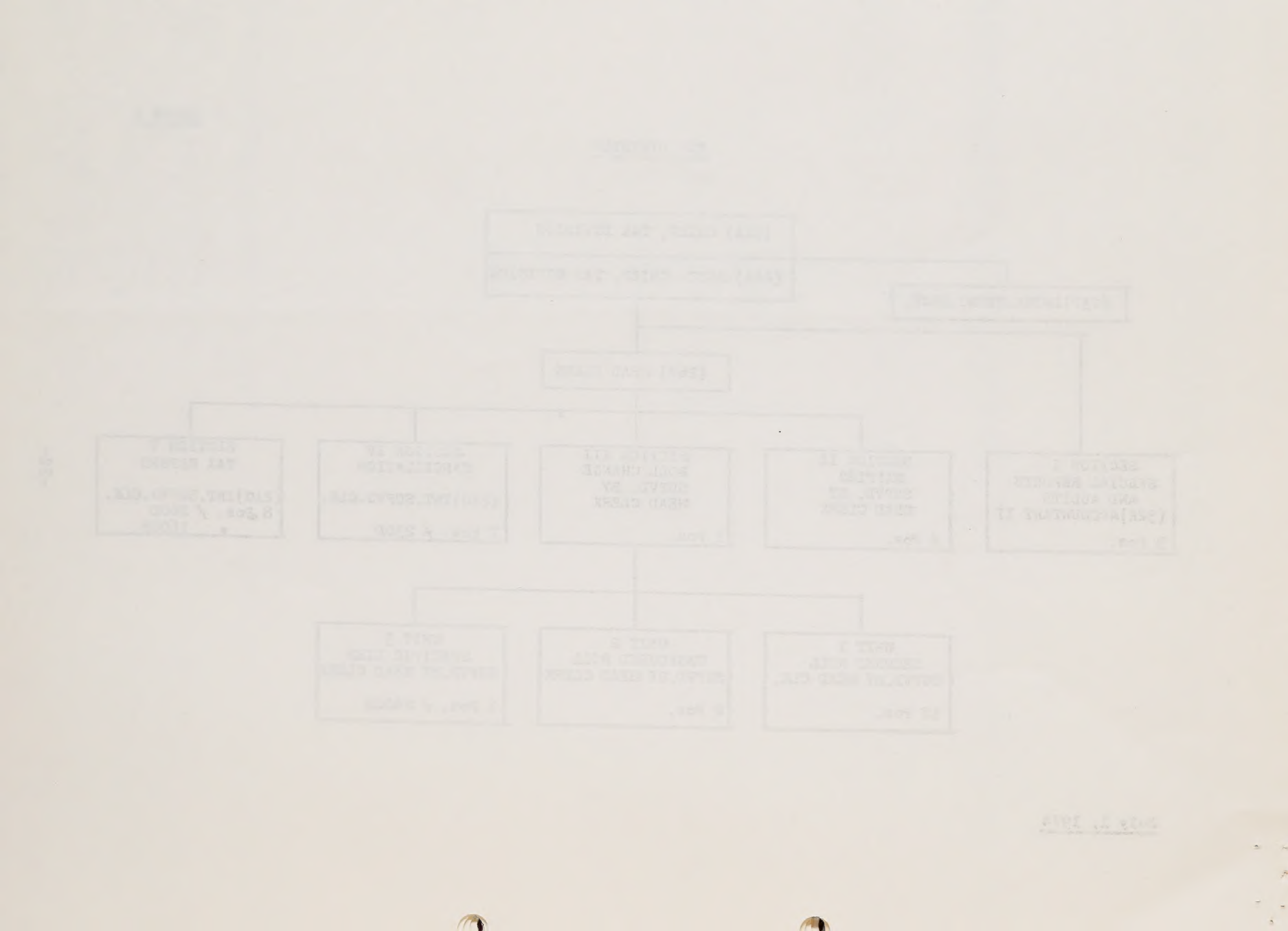
July 1, 1974

CHART F

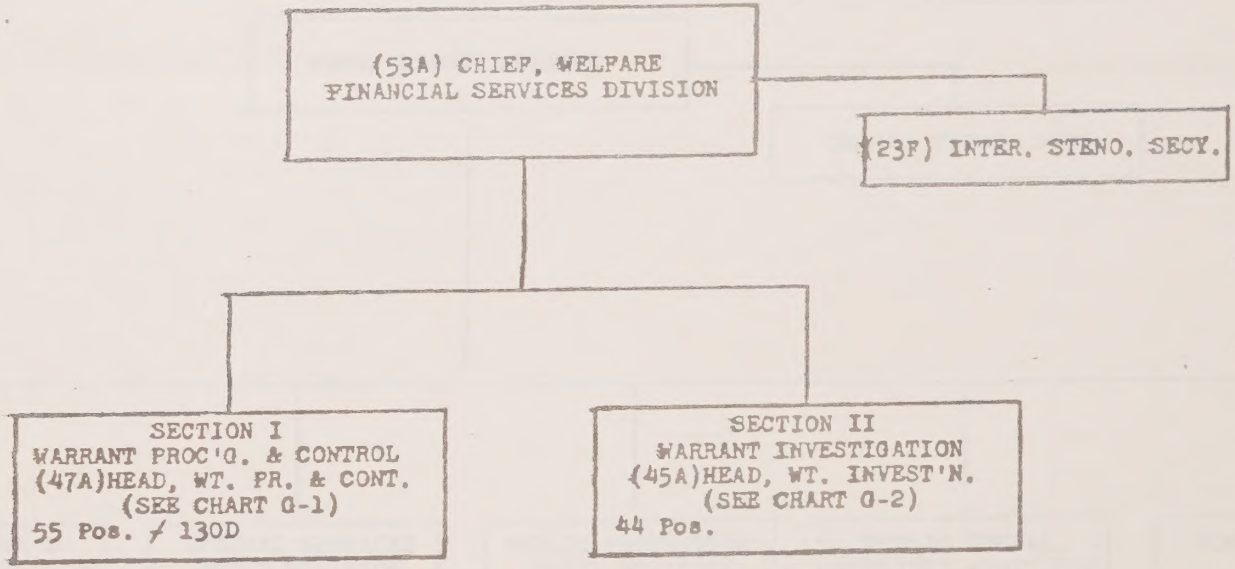
TAX DIVISION



July 1, 1974



WELFARE FINANCIAL SERVICES DIVISION

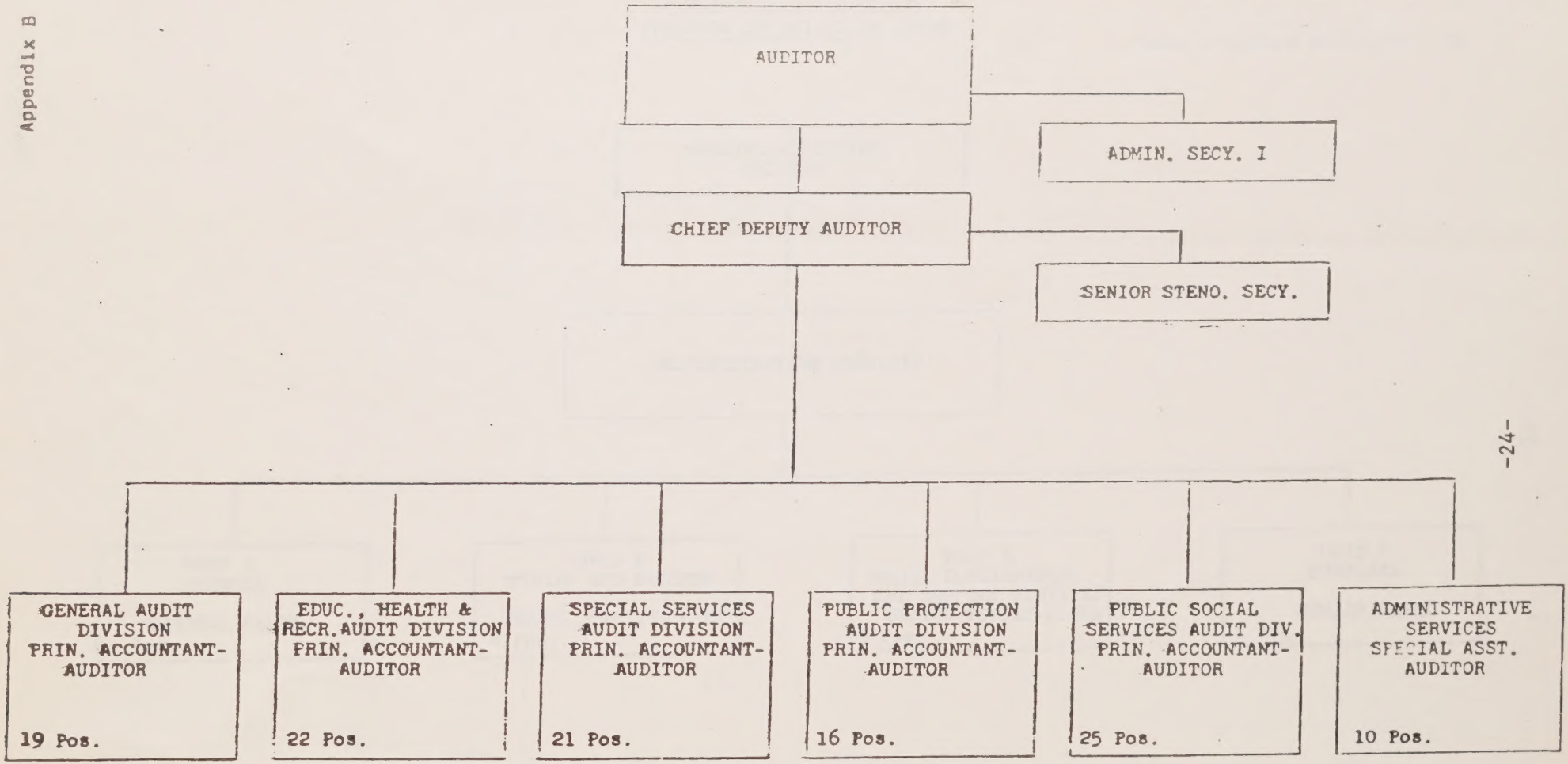


July 1, 1974

Appendix B

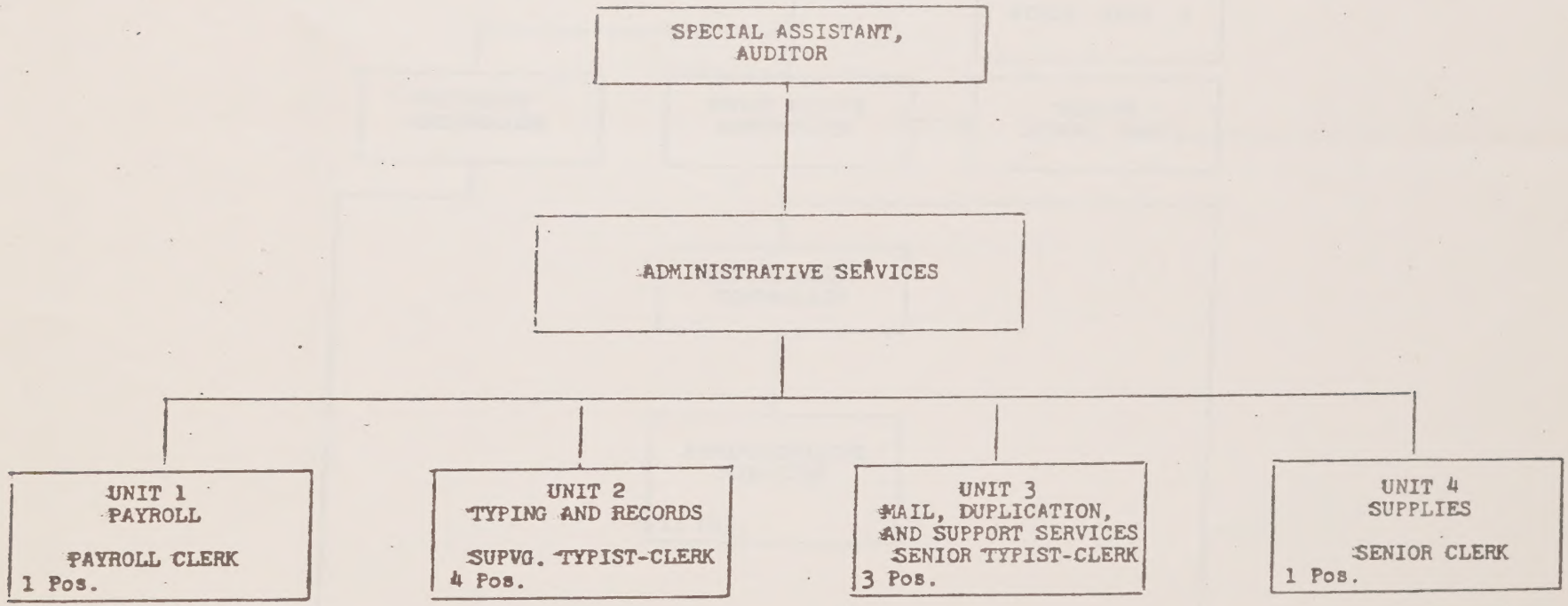
AUDITOR DEPARTMENT
PROPOSED ORGANIZATION CHART

Total Proposed Positions - 117



AUDITOR DEPARTMENT
ADMINISTRATIVE SERVICES
PROPOSED ORGANIZATION CHART

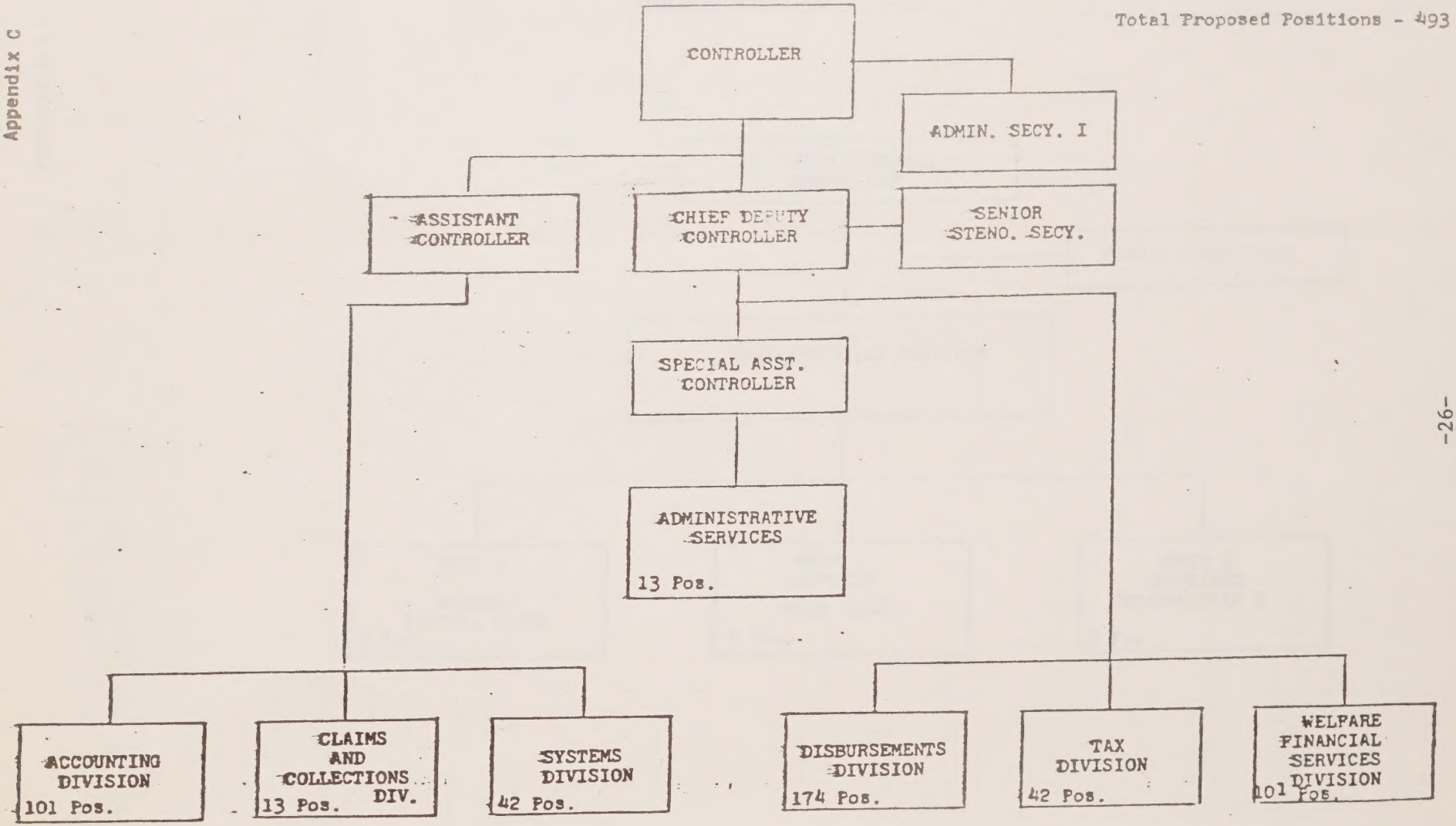
Total Proposed Positions - 10



Appendix C

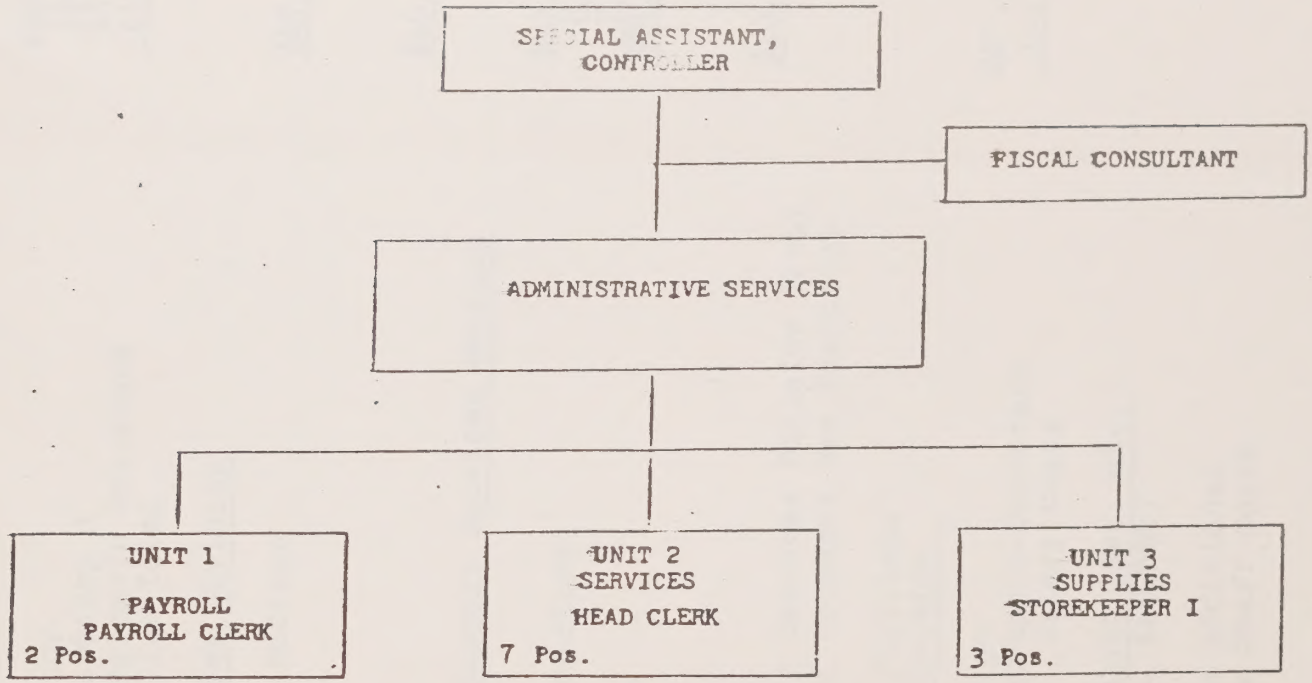
CONTROLLER DEPARTMENT
PROPOSED ORGANIZATION CHART

Total Proposed Positions - 493



CONTROLLER DEPARTMENT
ADMINISTRATIVE SERVICES
PROPOSED ORGANIZATION CHART

Total Proposed Positions - 14



AUDITOR DEPARTMENT (PROPOSED)
SCHEDULE OF PROPOSED ADDITIONAL ADMINISTRATIVE STAFF COSTS
1974-75 SALARIES (FIFTH STEP PLACEMENTS)

Salaries			
Executive Office			
1	Auditor	$39,564	
1	Chief Deputy Auditor	33,696	
1	Administrative Secretary I	14,040	
1	Intermediate Stenographic Secretary	11,734	
4	Executive Office Total		$99,034
Administrative Services Division			
1	Special Assistant-Auditor	$17,988	
Payroll Section			
1	Payroll Clerk	$10,380	
Mail, Duplicating & Support Services Section			
1	Senior Clerk	$10,004	
1	Intermediate Typist-Clerk	8,820	
1	Clerk - Messenger	7,005	
3	Section Total	$25,829	
Supplies Section			
1	Senior Clerk	$10,004	
6	Administrative Services Division Total		64,201
10	Total Costs of Proposed New Positions		$163,235
Less Cost of Deleted Positions from Existing Audit Division			
1	Chief, Audit Division	$27,924	
1	Intermediate Stenographic-Secretary	11,735	$39,659
	Net Additional Salary Costs		$123,576
Add Employee Benefit Cost (Ret. etc.) ($123,576 x 15.1% = $18,660)			18,660
	Total Proposed Additional Administrative Staff Costs		$142,236

April 1975

COUNTY OF LOS ANGELES
OFFICE OF THE COUNTY COUNSEL
648 HALL OF ADMINISTRATION
LOS ANGELES, CALIFORNIA 90012

JOHN H. LARSON, COUNTY COUNSEL
DONALD K. BYRNE, CHIEF DEPUTY

April 23, 1975

Los Angeles County Citizens Economy
and Efficiency Commission
163 Hall of Administration
500 West Temple Street
Los Angeles, Calif. 90012

Attention: Burke Roche,
Executive Secretary

Re: Proposed separation of duties of
the County Auditor-Controller

Dear Sir:

You have orally requested that we advise you as to what changes in the law would be necessary to separate the duties of the County Auditor-Controller to create two separate offices, and what legal problems would be entailed in making such a change.

You have advised us that a recommendation has been made that the duties of the County Auditor-Controller be separated on the basis of a Controller who carries on the day-to-day functions of keeping records, issuing warrants and other current duties that the Auditor-Controller now does on a day-to-day basis and a post audit function to be conducted by an Auditor who would examine the records of the Controller and other county officers and perform duties that auditors do.

At present, the duties of the Controller are provided in Government Code Sections 26880-26885. The duties of the Auditor are provided in Government Code Sections 26900-26922. Government Code Section 24000(e) provides that the County Auditor shall be ex officio the Controller. Government Code Section 26880 provides that the office of County Controller shall be held ex officio by the County Auditor.

In addition to these statutory provisions, there are a very large number of other code sections throughout the various codes which provide duties for county auditors. We have made a preliminary review of the statutes and this review shows that there are over 200 such code sections. There is also a great deal of crossover between the duties of the Auditor and the Controller as set forth in the statutes. Most of the duties which are provided for County Auditors are duties which would be duties of the Controller under the proposal which you are considering and some duties of the Controller would be Auditor duties.

In addition, there are 4 charter sections and 8 administrative code provisions relating to the County Auditor and his duties.

The proposed separation of the duties of the County Auditor-Controller could be accomplished either by amendment to the state statutes or amendment to the county charter. In either case, extensive and complex amendments would be required and practical problems would be encountered.

Amendment to the state statutes would require very extensive and complex new legislation, particularly in view of the number of existing sections relating to

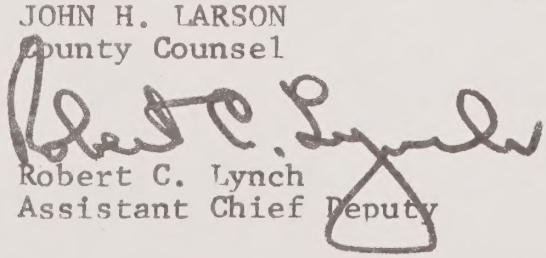
the duties of the Auditor. Any attempt to make special provision for a separate Auditor and Controller in Los Angeles County only might be subject to challenge since such legislation would depart from the constitutional requirement of statewide uniformity of laws relating to the duties of county officers. In addition, opposition from other counties to such legislation might be anticipated.

An amendment to the County Charter pursuant to Article XI, Sections 3 and 4(e) of the California Constitution would require somewhat less extensive drafting although the division of duties would require substantial amendment to the charter. In addition, such a proposed amendment would have to be submitted to the voters before it could become effective.

If we can be of further assistance to you in this matter, please advise.

Very truly yours,

JOHN H. LARSON
County Counsel

By 

Robert C. Lynch
Assistant Chief Deputy

RCL:hv

U.C. BERKELEY LIBRARIES
C101695577